No. 17-530

In the Supreme Court of the United States

WISCONSIN CENTRAL, LTD., ET AL.

v.

UNITED STATES OF AMERICA

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT

BRIEF FOR THE UNITED STATES

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QUESTION PRESENTED

Whether income realized by railroad employees upon the exercise of non-qualified stock options that petitioners granted to their employees in the course of employment is taxable "compensation" under the Railroad Retirement Tax Act, 26 U.S.C. 3231(e).

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OPINIONS BELOW

The opinion of the court of appeals (Pet. App. 1a-13a) is reported at 856 F.3d 490. The order and opinion of the district court (Pet. App. 16a-42a) is reported at 194 F. Supp. 3d 728.

JURISDICTION

The judgment of the court of appeals was entered on May 8, 2017. A petition for rehearing was denied on July 12, 2017 (Pet. App. 14a-15a). The petition for a writ of certiorari was filed on October 6, 2017. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

STATEMENT

1. a. Under the Railroad Retirement Tax Act (RRTA), 26 U.S.C. 3201 *et seq.*, railroad employees' "compensation" is subject to taxes that are used to fund a statutory program of retirement benefits. 26 U.S.C. 3201(a) and (b) (2012 & Supp. IV 2016). In structure

and purpose, the RRTA largely parallels the Federal Insurance Contributions Act (FICA) tax, which funds Social Security. See 26 U.S.C. 3101-3128 (2012 & Supp. IV 2016). Railroad employees are exempt from FICA. See 26 U.S.C. 3121(b)(9).

The RRTA defines "compensation" as "any form of money remuneration paid to an individual for services rendered as an employee to one or more employers." 26 U.S.C. 3231(e)(1). Congress has enacted several exceptions to the RRTA's definition of taxable "compensation." These include an exception for "qualified" stock options (QSOs), a type of stock option that generally enjoys favorable income- and employment-tax treatment under the Internal Revenue Code.[1] 26 U.S.C. 3231(e)(12) (exclusion of QSOs from RRTA definition of "compensation"); see 26 U.S.C. 421, 422 (providing that, if statutory requirements are met, an employee does not recognize income on the grant or exercise of a QSO, but instead recognizes capital gains upon the stock's disposition); 26 U.S.C. 3121(a)(22) (excluding QSOs from FICA taxes).

b. In 1937, when the RRTA was enacted, the U.S. Department of Treasury (Treasury Department) promulgated a regulation construing the term "compensation" under the RRTA as "all remuneration in money, or in something which may be used in lieu of money (scrip and merchandise orders, for example)." 26 C.F.R. 410.5 (1938). In 1994, the Treasury Department issued a new

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[1] An "option" to buy a stock permits an employee to buy the stock at a fixed price—the "strike price"—at a specified time or when specified conditions are met. See *Black's Law Dictionary* 1268 (10th ed. 2014); Pet. App. 3a. If the price of the stock rises above the strike price, the option is valuable because it permits the option-holder to buy stocks at a below-market price.

regulation providing that, "except as specifically limited by the [RRTA] * * * or regulation," compensation under the RRTA "has the same meaning as the term wages in [FICA] section 3121(a)." 26 C.F.R. 31.3231(e)-1(a)(1) (emphasis omitted). FICA defines "wages" as "all remuneration for employment, including the cash value of all remuneration (including benefits) paid in any medium other than cash." 26 U.S.C. 3121(a) (2012 & Supp. IV 2016).

c. During the period that the RRTA has been in effect, railroad companies have routinely used stock options, including non-qualified stock options (NQSOs), as a method of compensating employees. There is no dispute that an employee who exercises an NQSO realizes income, calculated as the difference between the fair market value of the shares awarded and the amount that the employees must pay for the shares. See 26 U.S.C. 83(a). For many years, railroads have also treated the income realized upon exercise of the option as "'money remuneration'" subject to tax under the RRTA, "and accordingly paid RRTA tax on" that income. Pet. App. 36a (citation omitted). Recently, however, several railroads have filed refund suits, asserting that NQSOs are not taxable under the RRTA because they are not a "form of money remuneration" and therefore do not fall within the definition of "compensation" contained in 26 U.S.C. 3231(e)(1). See Pet. App. 20a.

2. a. Petitioners are subsidiaries of Canadian National Railroad Company (CN) and operate railroads in the United States. Pet. App. 17a; Pet. 7. Since 1996, petitioners have compensated some employees with NQSOs for shares in CN, which is publicly traded on the New York Stock Exchange. Pet. App. 2a, 17a-18a; C.A. Separate App. 3. Petitioner's employees could exercise

their options and receive shares of CN stock, or they could exercise their options, ask the broker to immediately sell their shares, and simply receive cash that represented the difference between the strike price and the market price at the time that the option was exercised. Pet. App. 3a-4a.

In 2014, petitioners filed suit against the federal government, seeking about $13 million in tax refunds. Pet. App. 20a; Pet. 9. They alleged that they had overpaid RRTA taxes by paying taxes on the income that their employees realized when they exercised their stock options. Pet. App. 2a, 17a, 20a. They sought refunds of the employer and employee portions of RRTA taxes paid on those options between 2006 and 2013. *Ibid.*

b. After the parties filed cross-motions for summary judgment on a set of stipulated facts, the district court awarded summary judgment to the government. Pet. App. 17a-42a. The court applied the framework set out in *Chevron U.S.A. Inc.* v. *Natural Resources Defense Council, Inc.*, 467 U.S. 837 (1984), which the parties agreed was applicable. Pet. App. 20a. The court found the term "any form of money remuneration" ambiguous as applied to stock options like the NQSOs at issue here. *Id.* at 24a; see *id.* at 23a-25a. In finding ambiguity, the court noted that the government had cited dictionary definitions of "money" that readily swept in such stock options, *id.* at 23a-24a (discussing examples from *Oxford English Dictionary* and *Black's Law Dictionary*), while petitioners had cited definitions of "money" that were narrower, *ibid.* (citing *Oxford English Dictionary* and *Merriam-Webster Dictionary*).

The district court wrote that, "if anything, the statutory structure favors the Government's reading over [petitioners']." Pet. App. 25a. The court explained that

the RRTA's general definition of "compensation" is followed by numerous exceptions for noncash benefits, including an exception for qualified stock options, which suggested that "any form of money remuneration" includes noncash remuneration such as stock. *Id.* at 26a-29a. The court observed that "Congress would have had no need to carve" out such "exception[s] if it did not consider" the things excepted to be a "form of money remuneration" in the first place. *Id.* at 27a-28a. The court noted that this Court had applied a similar analysis in *United States* v. *Quality Stores*, 134 S. Ct. 1395, 1400 (2014), in holding that an express exemption for a type of severance payment in the parallel FICA statute supported the conclusion that severance payments generally were FICA wages, because the express exemption otherwise would have been unnecessary. Pet. App. 28a. The court also observed that numerous courts have recognized the parallels between RRTA and FICA, and have found that such parallels supported construing the statutes as having a similar reach. *Id.* at 30a-31a.

After finding the term "any form of money remuneration" ambiguous, the district court concluded that the agency had reasonably construed "compensation" to reach stock options in 26 C.F.R. 31.3231(e)-1, which generally aligns RRTA "compensation" with FICA wages. Pet. App. 37a-42a. The court reiterated its conclusion that the phrase "any form of money remuneration" could be construed to reach stock options and that the RRTA's overall structure supported that interpretation. *Id.* at 38a. The court further stated that "[c]ommon sense supports the reasonableness of Treasury's interpretation" because "[s]tock options are financial instruments" that "are readily and regularly convertible into cash, distinguishing them from most non-money

property." *Ibid.* The court also observed that this reading "eliminates the possibility that railroads could structure their compensation packages in such a way as to substantially reduce their RRTA tax burden." *Id.* at 39a.

c. The court of appeals affirmed. Pet. App. 1a-5a. The court held that the definition of "compensation" set forth in 26 U.S.C. 3231(e)(1) clearly includes stock options, rejecting petitioners' argument that the phrase "any form of money remuneration" refers solely to cash and a narrow set of cash equivalents. Pet. App. 1a-5a. The court stated that, regardless of whether stock was "a form of money remuneration" when the RRTA was enacted, stock is now the "practical equivalent" of cash. *Id.* at 4a. It also observed that "[t]he dictionary definition of money may remain constant while the instruments that comprise it change over time." *Ibid.*

The court of appeals further explained that the structure of the RRTA supports the conclusion that stock options constitute a "form of money remuneration." Pet. App. 4a. It emphasized that the statutory definition of "compensation" contains an exclusion for qualified stock options. *Ibid.* The court observed that the exception "supports an inference that *non-qualified* stock options, which are the options at issue in this case, are covered by the term 'money remuneration' and are therefore taxable." *Id.* at. 4a-5a. The court noted that Section 3231(e) also contains exceptions for several other non-cash benefits, "reinforc[ing] the inference that non-qualified stock options are 'money remuneration'" and therefore taxable. *Id.* at 5a (citing examples). The court added that the government's position made "good practical sense" because it avoids "the creation of

a tax incentive that might distort the ways in which employers structure compensation packages." *Ibid.* And it observed that its reading accorded with prior decisions addressing the classification of stock options under the RRTA. *Ibid.* (citing *BNSF Ry.* v. *United States*, 775 F.3d 743 (5th Cir. 2015); *CSX Corp.* v. *United States*, No. 15-cv-427, 2017 WL 2800181 (M.D. Fla. May 2, 2017)).

Judge Manion dissented. Pet. App. 5a-13a. He viewed it as "clear" that stock options do not constitute a form of "money remuneration" under the RRTA. *Id.* at 7a. Judge Manion relied on differences between the language of the RRTA and FICA, the definition of "money" in the edition of *Webster's New International Dictionary* that was issued in 1934, and inferences from other provisions of the Internal Revenue Code of 1939. *Id.* at 7a-9a. Judge Manion concluded that the RRTA's explicit exclusions for qualified stock options and other noncash remuneration did not support the government's position because those exclusions were enacted after the basic definition of RRTA "compensation" and did not impliedly repeal the earlier definition. *Id.* at 10a-12a. While recognizing that later enactments can shed light on an earlier provision that is ambiguous, *id.* at 12a (citing Antonin Scalia and Bryan A. Garner, *Reading the Law: The Interpretation of Legal Texts* 330 (2012)), Judge Manion concluded that the principle did not apply here because, in his view, the RRTA's definition of "compensation" unambiguously excludes stock options. *Ibid.*

DISCUSSION

Like most courts that have considered the question, the court of appeals correctly held that income realized on the exercise of non-qualified stock options is taxable

compensation under the RRTA. The Eighth Circuit, however, has reached a contrary conclusion. See *Union Pac. R.R.* v. *United States*, 865 F.3d 1045 (2017). The Court's review is warranted to resolve this conflict on an important legal question and to further the uniform administration of the federal tax laws.

1. The income realized upon the exercise of NQSOs is "compensation" subject to taxation under the RRTA. The RRTA defines "compensation" as "any form of money remuneration paid to an individual for services rendered as an employee to one or more employers." 26 U.S.C. 3231(e)(1). That term encompasses income from stock options. Many dictionary definitions of "money" reach items, like stock options, that are the practical equivalent of cash. See, *e.g.*, 6 *The Oxford English Dictionary* 603 (1931) (reprinted 1978) ("property or possessions of any kind viewed as convertible into money or having value expressible in terms of money"). And when, as here, "money" is used as an adjective, it often has a particularly broad meaning. *BNSF Ry.* v. *United States*, 775 F.3d 743, 753-754 (5th Cir. 2015) (citing *Random House Webster's Unabridged Dictionary* 1241 (2d ed. 2001)). Congress's use of the term "any" before "form of money remuneration" reinforces the breadth of the statutory phrase. See *United States* v. *Clintwood Elkhorn Mining Co.*, 553 U.S. 1, 7 (2008) (noting "expansive" reach of Internal Revenue Code's use of "any").

Consideration of 26 U.S.C. 3231(e) as a whole reinforces the conclusion that income from stock options is a "form of money remuneration." The express exclusions in Section 3231(e) for income from certain types of stock options, 26 U.S.C. 3231(e)(12), implies that income from other options is "compensation," cf. *United States*

v. *Quality Stores*, 134 S. Ct. 1395, 1398 (2014) (similarly inferring from exception for one type of severance payment that other severance payments are FICA "wages"). Additional exclusions for other types of noncash benefits likewise indicate that "money remuneration" is not limited to cash. *E.g.*, 26 U.S.C. 3231(e)(1)(i) (health insurance benefits); 3231(e)(5) (employee achievement awards in the form of tangible personal property); 3231(e)(9) (meals and lodging).

Petitioners argue (Pet. 16-17) that these exclusions are irrelevant because they were enacted after the term "money remuneration" itself. But as petitioners acknowledge, "later enactments" can shed light on the meaning of pre-existing statutory language. Pet. 17. Petitioners also state that the exclusion of qualified stock options from the definition of "compensation" would not be a nullity on their view of the statute because an employee who exercises an option can receive cash in lieu of a fractional share of stock "'when the number of shares an employee can acquire at exercise is not a whole number.'" *Ibid.* (citation omitted). But it is implausible that Congress enacted a broadly worded exclusion that extends to "transfer[s] of a share of stock" and "disposition[s]" of stock, 26 U.S.C. 3231(e)(12), simply to reach small amounts of cash paid in lieu of fractional shares of stock, see, *e.g.*, 26 U.S.C. 305; 26 C.F.R. 1.305-3(c). See *Quality Stores*, 134 S. Ct. at 1401 ("'When Congress acts to amend a statute, we presume it intends its amendment to have real and substantial effect.'") (quoting *Stone* v. *INS*, 514 U.S. 386, 397, (1995)). And the legislative history confirms that the exception for qualified stock options was aimed at excluding the options themselves. See H.R. Rep. No. 548, 108th Cong., 2d Sess. 144-145 (2004).

Petitioners suggest (Pet. 5-6) that "money remuneration" must be understood to exclude NQSOs because Congress made "all remuneration" generally taxable under FICA while making "any form of money remuneration" generally taxable under the RRTA. See 26 U.S.C. 3121(a) (2012 & Supp. IV 2016); 26 U.S.C. 3231(e). But in the period when the RRTA was enacted, railroad employees enjoyed various noncash benefits that had no readily ascertainable value and (unlike stock options) were not as readily described as "money." See *Taxation of Interstate Carriers and Employees: Hearings on H.R. 8652 Before the House Comm. On Ways and Means*, 74th Cong., 1st Sess. 6, 9 (1935) (noting that railroad workers enjoyed "seniority" protections, protections of the Adamson law guaranteeing an eight-hour workday, and rights to "safety appliances"). To the extent that "money" was intended as a limiting term, it may have been used to exclude from tax *de minimis* in-kind benefits that cannot readily be described as "money."

The court of appeals' understanding of "compensation" is confirmed by Treasury Department regulations, which have defined the term broadly since immediately after the statute was enacted. See 26 C.F.R. 31.3231(e)-(1)(a) (current regulation generally aligning compensation under the RRTA with wages under FICA); 26 C.F.R. 410.5 (1938) (prior regulation defining compensation to include "something which may be used in lieu of money (scrip and merchandise orders, for example)"); see also *Black's Law Dictionary* 1061 (2d ed. 1910) (defining scrip to encompass shares in a public company); *Black's Law Dictionary* 1514 (4th ed. 1968) (same). It also accords with the Railroad Retirement

Board's interpretation of an identical definition of "compensation" in the corresponding benefits provision of the Railroad Retirement Act, 45 U.S.C. 231(h)(1). See 20 C.F.R. 211.2(a); Memorandum from Gen. Counsel, R.R. Ret. Bd., to Chief of Audit & Compliance, Bureau of Fiscal Operations 1 (Dec. 2, 2005).

This prevailing interpretation aligning the RRTA's treatment of options with the treatment of options under the parallel FICA scheme, see *Hisquierdo* v. *Hisquierdo*, 439 U.S. 572, 573-575 (1979) (noting parallel remedial purposes of the railroad retirement system and Social Security), also avoids creating incentives to structure compensation through NQSOs to avoid employment taxes. Cf. *United States* v. *Silk*, 331 U.S. 704, 712 (1947) (explaining that a narrow construction of the remedial FICA statute "would only make for a continuance, to a considerable degree, of the difficulties for which the remedy was devised and would invite adroit schemes * * * to avoid the immediate burdens at the expense of the benefits sought by the legislation").

2. The question presented implicates a circuit conflict that warrants resolution by this Court. Most courts that have considered the question have held that NQSOs qualify as compensation under the RRTA. See Pet. App. 1a-5a; *BNSF Ry.*, *supra*; see also *CSX Corp.* v. *United States*, No. 15-cv-427, 2017 WL 2800181 (M.D. Fla. May 2, 2017). The Eighth Circuit, however, reached a contrary conclusion in *Union Pacific*, *supra*. The Seventh Circuit denied petitioner's request for rehearing en banc in this case, and the Eighth Circuit denied the government's request for rehearing en banc in *Union Pacific*. See Pet. 14a-15a; 10/20/17 Order, *Union Pacific*, *supra* (No. 16-3574). The conflict therefore is

unlikely to be resolved without this Court's intervention.

The question presented is important to the administration of the federal tax laws. The present dispute concerns about $13 million, Pet. App. 20a, and pending and recently decided cases alone involve a total of nearly $100 million in taxes on income from stock-based compensation, *ibid.*; *Union Pac. R.R.* v. *United States*, 2016 U.S. Dist. Lexis 86023, at *2 n.2 (D. Neb. July 1, 2016) ($55 million), rev'd, 865 F.3d 1045, 1047 (8th Cir. 2017); *BNSF Ry.*, 775 F.3d at 747 (over $16 million); Compl. at 3, *CSX Corp.* v. *United States*, No. 17-cv-243 (M.D. Fla. Mar. 2, 2017) (over $12 million); Compl. at 3, *CSX Corp.*, *supra* (No. 15-427) (over $2.3 million). And because the Fifth and Eighth Circuits have reached conflicting results, the two largest railroad employers in the nation—BNSF and Union Pacific—now face different legal rules in their home circuits concerning an important issue of employee compensation. Because this case presents a significant legal question on which the courts of appeals are divided, and provides a suitable vehicle for resolving that disagreement, this Court's review is warranted.

CONCLUSION

The petition for a writ of certiorari should be granted.

Respectfully submitted.

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